DEPARTMENT OF JUSTICE

Statement by

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Before the
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on
The State of Competition in the Telecommunications Marketplace
Three Years After Enactment of the Telecommunications Act of 1996

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Good morning, Mr. Chairman and members of the Subcommittee. It is a pleasure for me to appear before you today on behalf of the Antitrust Division of the Department of Justice to share our perspective on the progress of the Telecommunications Act of 1996 in the three years since it was signed into law. As always, we are grateful for your support and your interest in our work, and for your continuing dedication to ensuring that the Act achieves its purpose of bringing more competition to all sectors of the telecommunications industry.

A report released by the President's Council of Economic Advisors earlier this month describes with statistic after statistic a telecommunications marketplace that has become increasingly vibrant and robust in the wake of the 1996 Act and other pro-competitive policies. As reported by the CEA, hundreds of new firms have entered all sectors of the industry, new and incumbent firms have collectively invested tens of billions of dollars in facilities, services, and R&D, network capacity has increased, new technology is being deployed, and roll-out of advanced communications services is accelerating. Output has increased and prices have declined industry-wide. A copy of that report is attached. The 1996 Act and its procompetitive, deregulatory framework clearly set the right course.

Even with these tremendous strides, there remains much hard work to be done before the job of bringing competition to all parts of the telecommunications industry is finished. That is particularly true as to the local exchange. And we are still awaiting the day when a Bell Operating Company will have achieved the degree of local exchange market-opening required as a precondition for long distance entry. While some of this is taking longer than many might have liked, we at the Justice Department remain as convinced as ever that the Act's fundamental framework is sound and that, if we stay the course, we will continue making steady progress under the Act in bringing increased competition to all telecommunications markets, with its associated benefits to America's consumers.

Unfortunately, but perhaps predictably given the stakes involved, we have had to devote a significant amount of time and energy during these first three years to litigation -- regarding not only numerous specific local exchange market-opening disputes under the Act, but also the meaning of the Act, its jurisdictional scheme, and even its constitutionality.

Happily, in the last few months, the most fundamental of those court challenges have been resolved, and in favor of the Act. The D.C. Circuit and the Fifth Circuit have now rejected constitutional "bill of attainder" challenges to the Act, with the Supreme Court denying certiorari in the Fifth Circuit case.

And just last month, the Supreme Court issued its ruling in the Iowa Utilities Board case, which resolved the Act's major jurisdictional issues and upheld the FCC's authority to adopt a uniform national set of rules for implementation of local exchange market competition, including rules governing pricing and unbundled network elements.

The litigation is not over yet. Challenges to the substance of the FCC's pricing rules, which the Supreme Court did not rule on, remain to be considered by the Eighth Circuit. And the FCC will conduct further proceedings on its unbundled network element rules, which may be subject to further court challenges. But hopefully, the remaining issues can be dealt with quickly, so firms will focus more of their energies on business strategy instead of litigation strategy.

Local Competition

The Act embodies ambitious goals. It was designed to dismantle the legal, administrative, and regulatory structure that had governed local phone monopolies for decades, and replace it with a fundamentally new imperative: the local telephone market must be opened to competition. That is the Act's linchpin. The Act also envisioned competitive benefits to consumers from allowing the Bell Companies to enter and compete in long distance, once they had demonstrated that the local bottleneck logjam was broken.

The Act provided for three different distinct avenues of competitive entry into the local exchange for a competitor to use separately or in combination to build or assemble a competing service: first, using the competitor's own networks and facilities, interconnected with the incumbent carrier's network; second, using the unbundled network elements (or "UNEs") of the incumbent's network (or a combination of UNEs and the competitor's own facilities); and third, reselling the incumbent's retail service offerings. According to the CEA report, competitive local exchange carriers ("CLECs") have so far captured between 2 and 3 percent of the local exchange market as measured by lines, or about 5 percent of the market

measured by revenues. Resale and UNE account for more than 70 percent of lines served by CLECs, with facilities-based accounting for the remainder.

Although there are some important success stories, each of these avenues has its own limitations, and it is important to consider each of them separately.

Facilities-Based Competition

In the limited sphere where competitors have been able to reach numerous profitable customers and to limit their reliance on the incumbent carrier's network to simply connecting their own networks to it -- the urban business customer market -- competition has already made considerable headway. According to the CEA report, since the Act's passage new competitors have been authorized to enter local markets in every state in the U.S., and new carriers have entered all of the top 100 U.S. urban markets, as well as 250 smaller business trading areas. In fact, most major cities nationwide already have several facilities-based carriers competing with the incumbent for urban business customers. The number of switches owned by CLECs has grown from 65 before the Act to nearly 700 by the end of 1998, and the CLECs are building out their fiber networks at a fast clip. According to the FCC, the amount of fiber deployed by CLECs tripled between 1993 and 1997. And some estimates indicate that CLECs added more than 120,000 route miles of fiber to their networks during just the first three quarters of 1998. According to the CEA report, new entrants have successfully raised billions of dollars in financing in capital markets, increasing market capitalization for CLECs from almost nothing in 1993 to over $30 billion today. (This figure does not include debt financing or private venture financing).

These new entrants typically, and naturally, set their sights first on urban business customers as the most profitable slice of the local exchange market, just as the first competing long distance carriers did. Their focus has initially been limited to dense business districts, although their network coverage areas have begun to expand to reach other urban and suburban business "corridors" and office parks and, in some cases, have even begun to reach some residential apartment buildings.

In addition, there are now some encouraging signs regarding the prospects for cable company entry into local telecommunications markets -- although it is taking longer than some predicted. AT&T's decision to acquire TCI may have been what put this prospect back into the headlines recently. But a number of

cable companies are now well into the process of implementing the necessary upgrades to their cable systems to offer services such as local and long distance telephony and high-speed Internet access.

Wireless technology also offers some competitive potential. Market expansion and increased competition within the cellular and personal communications systems sectors is making these mobile wireless services more ubiquitous and affordable. In addition, several new competitors have begun to enter the local exchange market using fixed wireless technologies to provide the "last mile" of network connection to the customer. Finally, there are a number of firms hoping to enter the local exchange market using satellite technology.

While these developments are encouraging, facilities-based mass-market local entry efforts are still extremely limited and will take time to develop.

Unbundled Network Elements Competition

The avenue of using the incumbent's unbundled network elements, or a combination of unbundled elements and the competitor's own facilities, has often developed at a frustratingly slow pace, and the overwhelming majority of the very few mass-market customers served by competing carriers are resale customers.

The FCC estimates that CLECs are now using UNEs leased from incumbent carriers to serve approximately 260,000 U.S. customers. This represents a tiny portion of all local customers, and most of them are concentrated in a few areas. In most states the figure is still extremely low. For example, in Bell South's second Louisiana application, we found that only about 100 unbundled "loops" had thus far been ordered and provisioned in the entire state. In some other states, the figures are somewhat higher, but the fact remains that competition using UNEs -- an integral part of the Telecom Act's mandate -- still has far to go.

Resale Competition

In sheer numbers of new local customers signed up, resale competition appears to have been the most successful avenue thus far. But because competition is largely confined to marketing and billing for the incumbent's services -- with virtually total reliance on the incumbent's network -- resale does not allow for a full range of possible cost-saving innovations, so its potential competitive benefits

are limited. It is therefore highly unlikely to be a sufficient engine by itself for bringing the range of competitive benefits to mass-market consumers that the Telecom Act intended. Indeed, many CLECs, including AT&T and MCI, have abandoned the resale strategy. And a company that was once one of the nation's fastest growing local service resellers, with hundreds of thousands of local access lines, was forced by late last year to lay off almost half its employees.

In short, all three avenues for competitive entry have limitations that keep any one of them from being a complete solution. We need all three.

For broad, mass-market entry, the facilities-based avenue has limitations that can be solved only over time, and at considerable expense, as competing networks are physically extended to individual households. And the resale avenue has limitations that are inherent, because by nature it involves selling the incumbent's services. That is why we believe it is critical that the unbundled network elements route remain viable, and why so much attention is being focused on overcoming the difficulties in pursuing it. So let me talk for a minute about what those difficulties are.

Difficulties to Remedy in UNE Access

There have been two different kinds of UNE difficulties to deal with. The first has been the difficult legal process of clarifying and interpreting the Act's UNE mandates. The second has been the difficult technical and logistical process of implementing those mandates.

Let me first say a few things about the legal difficulties. The meaning of the UNE mandates has been a major focus of the litigation over the Act, figuring prominently in the Iowa Utilities Board case -- and perhaps predictably, given the extremely high stakes involved in exactly what CLECs are entitled to under the Act, in what manner, and at what price. Disputes over the meaning of these mandates have generated a tremendous amount of federal litigation, as well as related state commission rulings, arbitrations, and FCC rulemakings.

Some, though by no means all, of that skirmishing has been laid to rest by the Supreme Court's decision in the Iowa Utilities Board case. That decision has resolved most of the disputes to date involving unbundled network elements, and has rejected a variety of incumbent local exchange carrier policies and practices

which unnecessarily increased the costs or diminished the quality of services for competitors that use the incumbent's UNEs. For example, the Court upheld the FCC's rule prohibiting the incumbent carriers from the anticompetitive and wasteful practice of refusing to provide already-combined network elements in their combined form, thus forcing competitors to purchase them separately and recombine them on their own, at additional expense. While there are still some details to be worked out -- which will likely involve some further proceedings before the FCC and the federal courts -- we are hopeful that the Supreme Court's resolution of so many of these issues will now make it easier for important business and investment decisions to be made with more certainty regarding the legal landscape, propelling the competitive process forward as the Act intended.

Now let me turn to the technical and logistical difficulties. Quite apart from the difficulties in clarifying and interpreting the UNE mandates, the process of implementing the unbundling and interconnection requirements of the Act has been an enormously complex undertaking, requiring hard work and substantial expenditure by the incumbent local exchange carriers as well as by the new entrants. In particular, working out the technical details for sharing complex telecommunications networks, and developing the systems to support such sharing, has proven to be a formidable task.

However, as we have explained in our section 271 evaluations, it is such a formidable task precisely because access to operational support systems ("OSS") and other wholesale support processes is so essential to the development of mass-market competition. This access is what enables a competitor to sign up a new customer, process the customer's service order and transmit it to the incumbent, switch the customer's service from the incumbent to the competitor, provide a new service to the customer, provide accurate customer billing, and manage any repair or service problems.

Put simply, I do not believe that you will have mass-market competition in local markets without adequate non-discriminatory access to the incumbent carrier's OSS, a reliable means to measure the incumbent's wholesale performance, and an effective enforcement mechanism to ensure against poor performance or "backsliding" after section 271 approval.

We already have a telling example of the critical importance of OSS in the resale context, where access to the incumbent carrier's OSS is no less important. I

am sure many of you are aware of the efforts by MCI and others to roll out mass-market resale service in California in late 1996 and into 1997. MCI was quite successful in marketing its new local service offering, and in the ensuing months signed up some 30,000-35,000 customers wishing to switch their local service provider from Pacific Bell to MCI. But Pacific Bell did not have adequate electronic systems and wholesale support processes developed to handle MCI's order volume. Pacific Bell was not able to keep up with processing these orders manually, which resulted in huge backlogs of thousands of orders. Pacific Bell attempted to remedy the problems by adding hundreds of employees to help with manual order processing, but the order backlogs remained or grew even larger. In the end, MCI was forced to withdraw its resale offering in California. I use this example not to single out Pacific Bell, but rather to underscore why these OSS interfaces and support process are so very important if we are to give local market consumers meaningful competitive options.

Role of the Department of Justice

Now let me turn more specifically to the Department of Justice's role in all this. The role given to us in the Act is to advise the FCC on Bell Company applications for long distance entry under section 271. And, of course, to enforce the antitrust laws. But we have always viewed our responsibility under the Act as more than merely giving a thumbs-up or thumbs-down to section 271 applications as they come in. That's why we not only articulated our standard for recommending section 271 approval -- that the local exchange market involved be "fully and irreversibly open to competition" -- but also have devoted considerable resources to helping the Bell Companies and all others concerned understand what we mean by that standard. And we have tried to do this not only in the competitive analyses we have provided for section 271 applications to date, but also in formal and informal discussions with everyone concerned.

Recognizing the critical importance of OSS access to the process of opening local exchange markets, as part of our overall section 271 responsibilities we have, when asked, collaborated with the efforts of state commissions in New York, Texas, and elsewhere to tackle the OSS issue. There is no question that non-discriminatory access to OSS has emerged as one of the remaining hurdles to the market opening that is an essential precondition to the Bell Companies' gaining section 271 approval at both the state commission and FCC level. These "OSS testing" proceedings at the state level have demonstrated that developing these

systems, interfaces, and processes is difficult, but I think they have also demonstrated that it can be accomplished. In addition, the involvement of the state commissions and independent third parties in the testing processing has been particularly useful not only in pointing out problems and moving forward to remedy them, but also in removing some of the "he said-she said" disputes between the Bell Companies and the new entrants from the debate.

These proceedings are well underway, and we will continue to work with the state commissions and the industry to complete them. We hope that these proceedings will identify Bell Companies whose OSS and other wholesale support processes may now be sufficient to obtain section 271 approval, or at a minimum that they will clearly demonstrate what steps we still need to take towards local market opening and section 271 approval.

Importance of Section 271

As we reflect on the first three years of the Act, I believe one of the most important lessons we can take from our experience is how absolutely critical section 271 is to achieving the Act's market-opening goals. The progress toward opening the local exchange markets that many have complained is far too slow has taken place in good measure because of the prospect of long distance entry for the Bell Companies as a reward. One of the most ambitious aspects of the Act is that it requires and expects the incumbent local exchange carrier to assist competitors that wish ultimately to take away its customers. Imagine how much more difficult this process would be without the incentive of long distance entry for the Bell Companies.

For the same reasons, the Department has paid considerable attention, in developing our competitive standard for assessing section 271 applications, to the question of how to ensure that a local exchange market remains open even after the application has been approved and the incentive of gaining entry is no longer a factor. We are hopeful that the collaborative proceedings in New York, Texas, and elsewhere will help fine-tune and implement the performance measures, the reporting requirements, the performance benchmarks, and the regulatory and contractual enforcement mechanisms that will be necessary to protect against such post-271 entry "backsliding."

Conclusion

We never expected the monopoly structure that has characterized the local exchange for most of this century to be removed overnight. But Congress made the right decision three years ago in deciding that it was time for competition to be the touchstone for our national telecommunications policy in all markets, including the local exchange. The Act reflects Congress's well-founded faith in our free-market economy, faith that in the telecommunications industry as in others, competition will strengthen our economy and ensure that American consumers benefit from increased choices, enhanced offerings, and better prices.

Just as MCI and others refuted the many pessimists who said that competition in long distance would never be achieved -- as recently as 1986, one observer predicted that AT&T would find itself alone in the basic long-distance market by the end of the century -- so will the many large and small CLECs ultimately prove that competition is the right choice in local markets as well.

Before we get there, there is a lot of hard work yet to be done. Rather than legislatively revisiting the Act, I think the right approach is to maintain our efforts to make the Act work. In my view, its basic framework is sound. The difficulties we have experienced in implementing it are of the kind to be expected with such an ambitious undertaking. After all the work that has gone into implementing the Act, and litigating it to a common, judicially interpreted understanding where required, I am concerned that revising it at this point would only lead to more litigation and more delay.

The work before us now is not to set the policy -- you have already set the policy, and it is the right one -- but to continue sweating the details that go into implementing that policy. We in the Justice Department are used to sweating these kinds of competitive details. We remain committed to the pro-competitive goals of the Telecommunications Act, and we will continue working vigorously to help enforce them.

I urge you to read the attached Council of Economic Advisors report. It lays out the remarkable competitive vibrancy of the telecommunications industry on a macro level. As we continue to work in the trenches to ensure all markets are competitive, we should not lose sight of the dynamism of the telecommunications marketplace writ large and the instrumental role the 1996 Act plays in this story.